

Letter of Transmittal



STATE OF WASHINGTON
DEPARTMENT OF RETIREMENT SYSTEMS
P.O. Box 48380 • Olympia, Washington 98504-8380

December 20, 2005

The Honorable Christine Gregoire, Governor
Members of the Fifty-Ninth Legislature
Members of the Select Committee on Pension Policy
State of Washington
Olympia, Washington 98504

We are pleased to present to you the Department of Retirement Systems' Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. This CAFR is designed to comply with the requirements of chapters 41.50.050(4) RCW, 41.50.780(9) RCW, and 41.04.630(2) RCW.

Responsibility for the accuracy of the data and the fairness and completeness of this presentation, including all disclosures, rests with the management of the Department of Retirement Systems (DRS). To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to provide a fair representation of the financial position and results of the operations of the department.

This report consists of five sections:

- (1) The Introductory Section, which contains a message from the Director of DRS, this letter of transmittal, which is designed to complement the Management's Discussion and Analysis with additional narrative, other data currently beyond the scope of Generally Accepted Accounting Principles (GAAP), and information about the agency's administrative structure and operations;
- (2) The Financial Section, which contains the report of the independent auditors, Management's Discussion and Analysis, the financial statements, the notes to the financial statements, required supplementary information, and additional financial information;
- (3) The Investment Section, which contains the report of the Washington State Investment Board (WSIB), investment policies, results, associated fees and commissions, and additional investment information;
- (4) The Actuarial Section, which contains the report of the State Actuary, a summary of actuarial assumptions and methods, and actuarial schedules and data; and
- (5) The Statistical Section, which contains significant data pertaining to the retirement systems.

Agency Description and History

DRS administers seven statewide public employee retirement systems, which are comprised of 11 defined benefit pension plans and three combination defined benefit/defined contribution plans. The purpose of DRS is to administer pension plan coverage for state employees, teachers and classified educational employees, law enforcement officers and fire fighters, and other employees of participating political subdivisions. As of June 30, 2005, there were 1,277 covered employers participating in multiple systems and/or plans administered by DRS. The eligibility requirements and provisions of each plan can be found in Note 2 of the Notes to the Financial Statements. DRS also administers a deferred compensation program and a dependent care reimbursement program. Additionally, DRS is responsible for all accounting and reporting services for the Judicial Retirement Account (JRA), which is a defined contribution pension plan administered by the State of Washington Administrative Office of the Courts.

The Washington State Legislature created the Department of Retirement Systems in 1976 to administer the Public Employees' (PERS), Teachers' (TRS), Law Enforcement Officers' and Fire Fighters' (LEOFF), Washington State Patrol (WSPRS), and Judicial (JRS) retirement systems, and the Judges' Retirement Fund (Judges).

Significant events in DRS history are listed below:

1930s-1940s

The PERS, TRS, WSPRS, Judges and many local police and fire fighters' retirement systems were created.

1950s-1960s

Independent administration of individual retirement systems continued.

1960s-1970s

Local police and fire fighters' retirement systems were consolidated into LEOFF.

1976

The Department of Retirement Systems was created to administer state retirement systems. The Office of the State Actuary was created to provide pension cost estimates.

1977

The PERS Plan 2, TRS Plan 2, and LEOFF Plan 2 were created.

1981

The Washington State Investment Board was created to handle investment of all state trust funds.

1987

The Joint Committee on Pension Policy was created.

1995

The TRS Plan 3 was created effective July 1, 1996.

1996

The state Deferred Compensation and Dependent Care programs were transferred to DRS. DRS assumed accounting and reporting responsibility for the Judicial Retirement Account (JRA) defined contribution plan.

1998

The School Employees' Retirement System (SERS) Plans 2 and 3 were created effective September 1, 2000. The Pension Funding Council was created.

1999

The PERS Plan 3 was created effective March 1, 2002, for state and higher education employees, and effective September 1, 2002, for local government employees.

2001

The WSPRS Plan 2 was created effective January 1, 2003.

2003

The LEOFF 2 Board was established effective July 1, 2003.

The Joint Committee on Pension Policy became the Select Committee on Pension Policy effective July 27, 2003.

2004

The Public Safety Employees' Retirement System (PSERS) was created effective July 1, 2006.

Accounting System and Internal Control

This report has been prepared to conform with the principles of accounting and reporting established by the Governmental Accounting Standards Board (GASB). The basic financial statements are presented in accordance with guidelines established by GASB Statement No. 25, Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans, and other GASB statements, as appropriate. Specific accounting treatments are detailed in the Notes to the Financial Statements found in the Financial Section of this report.

In March 2003, the GASB issued Statement No. 40 (GASB 40), Deposit and Investment Risk Disclosures, which amended and/or superseded certain provisions of GASB 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements, and Reverse Repurchase Agreements; GASB 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans; and GASB 28, Accounting and Financial Reporting for Securities Lending Transactions. Effective for Fiscal Year 2005 reporting, DRS implemented the provisions of GASB 40. GASB 40

has no monetary impact on the financial statements of DRS, but does require additional disclosure. As a result of this implementation, the deposit and investment information included in Note 1 to the financial statements has been modified and expanded. Deposit risk disclosures now more clearly address and disclose custodial credit risk. Investment risk disclosures now specifically address and display credit risk (including custodial credit risk and concentration of credit risk), interest rate risk and foreign currency risk.

Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the government are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management. In addition, budgetary controls are maintained by the Office of Financial Management and the Washington State Legislature.

Funding

The goal of pension funding is to accumulate enough money during a member's working career to pay retirement benefits after the member retires. Measurements of funding status indicate how well a retirement plan is accomplishing that goal. There are two standard indicators of funding status: the funding ratio and the existence of an unfunded liability. Both measure the benefit obligations, or liabilities, of a plan against its assets. If the funding level is adequate, the ratio of total accumulated assets to total liabilities will be larger and more funds will be available for investment purposes. Also, an adequate funding level gives the participants assurance that their pension benefits are secure.

The actuarial value of assets available as of the latest actuarial date for all systems was \$44,138 million. The accrued liability is \$48,423 million. The accrued liability exceeds the net actuarial value of assets available for benefits by

\$4,285 million. The ratio of assets to liabilities is 91 percent compared to 93 percent last year. Current contribution rates remain in keeping with the goal of attaining a funding ratio of 100 percent by the amortization dates applicable to each plan (June 30, 2024, or earlier), as required by chapter 41.45 RCW. Valuations are performed for all DRS-administered retirement systems on a yearly (October 1 to September 30) basis. These calculations are prepared by the Office of the State Actuary and reflect the latest valuation results. Additional actuarial information is included in the Actuarial Section of this report.

Investments

The Washington State Investment Board (WSIB) has sole authority and responsibility for the investment of all state and local pension fund assets. The enabling statute requires the WSIB to "... establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk." The policies adopted by the WSIB include provisions for the setting of strategic asset allocation objectives, as well as strategies and return objectives for individual asset classes. A summary of the asset allocation can be found in the Investment Section of this report. For Fiscal Year 2005, the commingled trust fund (CTF) investments provided a 13.34 percent rate of return. The CTF annualized rate of return over the last three years was 10.71 percent and 3.63 percent over the last five years. The day-to-day management of pension fund assets is the responsibility of WSIB staff. Further investment information is included in the Investment Section of this report.

Departmental Initiatives

The department's activities are highlighted in the Introductory Section of this report under the heading "Overview of Agency Operations."

Independent Audit

An audit of DRS' basic financial statements was conducted by Peterson Sullivan PLLC, independent auditors. The independent auditor's report on our financial statements is included in the Financial Section of this report.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to DRS for its comprehensive annual financial report for the fiscal year ended June 30, 2004. This was the eleventh consecutive year that DRS has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In November 2005, DRS also received the Public Pension Standards 2005 Award from the Public Pension Coordinating Council (PPCC). The PPCC is a coalition of three national associations, serving public pension funds, that represents substantially all employees of state and local government in the United States. Eligibility for this award entails meeting the professional standards for plan design and administration set forth in the Public Pension Standards. These standards are intended to reflect minimum expectations for public retirement system management and administration.

Acknowledgments

This report was made possible by the staff of DRS based in part on information provided by the Office of the State Actuary, the Office of Financial Management, and the Washington State Investment Board. Each member of these agencies has our sincere appreciation for the contributions made in the preparation of this report. The report will be provided to the Governor, the members of the Select Committee on Pension Policy, the members of the DRS Advisory Committee, and other interested parties.

This report is intended to provide complete and reliable information that can be used to make management decisions, determine compliance with legal provisions, and evaluate responsible stewardship of DRS-administered retirement system funds.

Respectfully submitted,



Sandra J. Matheson
Director

Certificate of Achievement

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Washington State Department
of Retirement Systems,
Washington

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial
Reporting is presented by the Government Finance Officers
Association of the United States and Canada to
government units and public employee retirement
systems whose comprehensive annual financial
reports (CAFRs) achieve the highest
standards in government accounting
and financial reporting.



Nancy L. Ziehl

President

Jeffrey R. Enen

Executive Director



**Public Pension Coordinating Council
Public Pension Standards
2005 Award**

Presented to

Washington State Department of Retirement Systems

In recognition of meeting professional standards for
plan design and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in black ink, reading 'Alan H. Winkle'. The signature is fluid and cursive, with the first name 'Alan' being more prominent.

Alan H. Winkle
Program Administrator